

**IN THE CHANCERY COURT FOR LEWIS COUNTY, TENNESSEE
AT HOHENWALD**

In re: Sentinel Trust Company

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Case No. 4781

**MEMORANDUM IN SUPPORT OF MOTION OF
STEWART COUNTY, TENNESSEE, TO INTERVENE
AND TO TRANSFER ESCROW ACCOUNTS TO A NEW ESCROW AGENT**

Sentinel Trust Company (STC) holds in escrow a U.S. Treasury Note par value \$5,705,000 maturing on August 31, 2004. The Treasury Note was purchased with funds received from Stewart County pursuant to an escrow agreement that calls for STC to use proceeds from the Treasury Note to pay certain holders of bonds issued by Stewart County. The payment is due September 1, 2004. STC was placed in liquidation June 18, 2004, by action of the Tennessee Commissioner of the Department of Financial Institutions. Stewart County seeks an order from this Court directing the Liquidator for STC to make the payment to the bondholders or, alternatively, to appoint a successor agent to make the payment.

FACTS

In 2003, Stewart County issued School Refunding Bonds, Series 2003, in the amount of \$6,035,000 for the purpose of refunding School Bonds, Series 1996, dated December 1, 1996, and thereby reducing its debt service payments. Stewart County entered into a Refunding Escrow Agreement¹ with STC that provides for STC to purchase and hold in escrow, separate from all

¹ The Refunding Escrow Agreement is Exhibit 1 to Stewart County's Motion to Intervene and to Order Payment of Bonds.

other funds, a U.S. Treasury Note par value \$5,705,000 maturing on August 31, 2004, and to use the proceeds to pay the School Bond Series 1996 of \$5,769,218.75, on September 1, 2004. The escrow will be referred to herein as the "Stewart County Funds."

STC was placed in liquidation June 18, 2004, by action of the Tennessee Commissioner of the Department of Financial Institutions.

Failure to authorize payment of the 1996 Series Bonds on September 1, 2004, will result in their default.

Section 3.10 of the Refunding Escrow Agreement provides for the Court to appoint a successor escrow agent.

LAW AND ARGUMENT

The Stewart County Funds Are Not Part of STC's Estate and May Not Be Used for Any Purpose Other Than to Pay the Holders of the 1996 Series Bonds

STC holds the Stewart County Funds in trust for the benefit of the 1996 Series bondholders. A valid and enforceable express trust exists where the following elements are present: 1) a trustee who holds trust property and who is subject to the equitable duties to deal with it for the benefit of another, 2) a beneficiary to whom the trustee owes the equitable duties to deal with the trust property for his benefit, and 3) identifiable trust property. *Kopsom-but-Myint Buddhist Center v. State Board of Equalization*, 728 S.W.2d 327, 333 (Tenn. App. 1986); *Stevenson v. J.C. Bradford & Company*, 277 F.3d at 850 (applying Tennessee law).

The Refunding Escrow Agreement states:

SECTION 2.07. Irrevocable Escrow Created. The deposit of monies, Government Securities, matured principal amounts thereof, and investment proceeds therefrom in the Escrow Fund shall constitute an irrevocable deposit of said monies and Government Securities for the benefit of the holders of the Outstanding Bonds, except as provided herein with respect to amendments permitted under Section 4.01 hereof. All the funds and accounts created and established pursuant to this Agreement shall be and constitute escrow funds for the purposes provided in this Agreement and shall be kept separate and distinct from all other funds of the

County and the Agent and used only for the purposes and in the manner provided in this Agreement.

STC holds the Stewart County Funds for the benefit of the Stewart County bondholders.

STC accepted the Stewart County Funds with the express agreement that it is obligated to maintain the funds in accordance with the Refunding Escrow Agreement and to pay the bonds when due. The trust property is clearly identifiable. Stewart County designated the security to be purchased, and STC agreed to purchase and did purchase U.S. Treasury Securities as described in Exhibit B to the Refunding Escrow Agreement. Information regarding the security for their bonds was available to the bondholders. All elements of an express trust are present.

Accordingly, STC is trustee of the Stewart County Funds. *See Kopsom-but-Myint Buddhist Center v. State Board of Equalization*, 728 S.W.2d 327, 333 (Tenn. App. 1986) (defines trust); *Stevenson v. J.C. Bradford & Company et al. (In re Cannon)*, 277 F.3d 838, 850 (6th Cir. 2002) (defines express trust under Tennessee law).

When property is placed in escrow or in trust, the escrow agent or trustee holds legal title to the property; however, equitable title remains vested in the grantor until the happening of a condition or contingency triggering either the dissolution of the trust/escrow and return of the corpus to the grantor or the transfer of equitable title to the beneficiary. *See, e.g., Begier v. Internal Revenue Serv.*, 496 U.S. 53, 110 S.Ct. 2258, 2263, 110 L.Ed.2d 46 (1990); *Stevenson v. J.C. Bradford & Company et al. (In re Cannon)*, 277 F.3d 838, 850-852 (6th Cir. 2002); *Old Republic National Title Insurance Company v. Tyler*, 206 B.R. 394, 402 (E.D. Va. 1997). Since equitable title to property held in escrow or trust does not pass to the trustee/escrow agent, funds held in escrow by a debtor in liquidation are not part of the debtor's estate. *See, e.g., Begier v. Internal Revenue Serv.*, 110 S.Ct. at 2263 (Because debtor in bankruptcy does not own an equitable interest in property that he holds in trust for another, that property is not property of the

debtor's bankruptcy estate.); *Stevenson v. J.C. Bradford* at 850-852 (Applying Tennessee law, the Court found that funds the debtor held in escrow did not become part of the debtor's bankruptcy estate.) *Old Republic National Title Insurance Company v. Tyler*, 206 B.R. at 402 (To the extent traceable, funds held in escrow by debtor were not part of debtor's bankruptcy estate.).

Stevenson v. J.C. Bradford involved a debtor in Chapter 7 bankruptcy who, prior to the bankruptcy, had misappropriated funds from an escrow account held for another person. The debtor had deposited his own personal funds into the account in an effort to repay some of the misappropriated funds. The Chapter 7 trustee sought to use his statutory avoidance power to recover funds transferred from the escrow account. The 6th Circuit Court of Appeals refused to allow it even though the debtor had deposited his own personal funds into the account. Applying Tennessee law, the Court found that funds the debtor held in escrow did not become part of debtor's bankruptcy estate because the debtor possessed only legal title to funds and not equitable title. The commingling of his own funds did not result in any portion of the escrow becoming part of his estate as the deposits were merely restitution for misappropriated funds.

Like the debtor in *Stevenson v. J.C. Bradford*, STC holds legal but not equitable title to the escrowed Stewart County Funds. As such, the funds are not part of STC's estate. STC has no right to dispose of the Stewart County Funds other than by paying the bondholders as provided in the Refunding Escrow Agreement.

The Stewart County Funds Must Be Paid to the Bondholder's Either By the Liquidator or by A Successor Escrow Agent

The Refunding Escrow Agreement requires that the Stewart County Funds be paid to the 1996 Series bondholders:

SECTION 2.03. Disposition of Escrow Funds. The Agent shall without further authorization or direction from the County collect the principal and interest on the

Government Securities promptly as the same shall fall due. From the Escrow Fund, to the extent that monies therein are sufficient for such purpose, the Agent shall make timely payments to the proper paying agent or agents, or their successors, for the Outstanding Bonds of monies sufficient for the payment of the principal of and interest on the Outstanding Bonds as the same shall become due and payable. . . . When the Agent has made all required payments of principal and interest on the Outstanding Bonds to the paying agent as hereinabove provided, the Agent shall transfer any monies or Government Securities then held hereunder to the County and this Agreement shall terminate.

* * * *

SECTION 2.08. Redemption of Outstanding Bonds. The Agent shall give notice of a September 1, 2004 redemption in accordance with the resolution authorizing the issuance of the [bonds to the holders of such bonds].

Any use of the funds other than as provided in the Refunding Escrow Agreement would constitute a breach of STC's fiduciary duty and conversion of the funds. A breach of the duty to deliver escrowed property as described in the escrow agreement is considered conversion of the property not delivered. *Stevenson v. J.C. Bradford* at 851 (citing 28 Am. Jur.2d *Escrow* § 27 (1966)).

State law governing the liquidation of financial institutions, including STC, requires the Commissioner of the Department of Financial Institutions to promptly terminate the fiduciary responsibilities of a financial institution placed in liquidation, and it provides for the appointment of a successor fiduciary. Tennessee Code Annotated § 45-2-1504(c) provides that:

As soon after the commencement of liquidation as is practicable, the commissioner shall take the necessary steps to terminate all fiduciary positions held by the state bank and take such action as may be necessary to surrender all property held by the bank as a fiduciary and to settle its fiduciary accounts. Such fiduciary accounts may be transferred by the commissioner to another qualified corporate fiduciary as determined by the commissioner, and notice of such transfer must be given by registered mail to the parties by the transferee corporate fiduciary.

The Refunding Escrow Agreement was drafted to ensure the appointment of a successor escrow agent to carry out its terms in the event STC became insolvent or unable to serve. It states:

SECTION 3.08. Qualification of Agent. There shall at all times be an Agent hereunder that shall be a corporation or banking association organized and doing business under the laws of the United States or any state, located in the State of Tennessee, ... In case at any time the Agent shall cease to be eligible in accordance with the provisions of this section, the Agent shall resign immediately in the manner and with the effect specified herein.

SECTION 3.10. Removal of Agent. In case at any time the Agent shall cease to be eligible in accordance with the provisions of Section 3.08 ... or shall be adjudged a bankrupt or insolvent or a receiver of the Agent or any of its property shall be appointed, ..., then in any such case, the County may remove the Agent and appoint a successor by resolution of its governing body or any such bondholder may, on behalf of himself and all others similarly situated, petition any court of competent jurisdiction situated in the County for the removal of the Agent and the appointment of a successor. Such court may thereupon, after such notice, if any, as it may deem proper, remove the Agent and appoint a successor who shall meet the qualifications set forth in Section 3.08. ... (Emphasis added.)

Although Stewart County is authorized to unilaterally appoint a new escrow agent and paying agent under Section 3.10 of the Refunding Escrow Agreement, it has chosen to seek this Court's assistance in carrying out the terms of the Agreement. Stewart County respectfully requests that the Court order the Liquidator to pay the bondholders in accordance with the terms of the Refunding Escrow Agreement, or, in the alternative, appoint a successor escrow agent and paying agent. In the event the Court decides to appoint a successor escrow agent and paying agent, Stewart County requests that the Court order the Liquidator to transfer the funds promptly, as Payments on the 1996 Series Bonds are due September 1, 2004. Stewart County further requests pursuant to Rule 62.01 of the Rules of Civil Procedure, that the Order not be stayed after entry.

Respectfully submitted,

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